

The Dabhol Power Project Settlement

What Happened? and How?

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2 Times
By late 2001, the \$2.9 billion Dabhol power project had become, for the second time, a leading international investment disaster.

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Six months earlier, cash flow from the Maharashtra State Electricity Board (MSEDB), the sole offtaker, had stopped. After a year or so of smooth operations followed by months of slow and defaulted payments, Dabhol Power Company (DPC) sent MSEB a notice of arbitration in May 2001. MSEB responded by, among other things, seeking an injunction to block that arbitration and by repudiating the power purchase agreement (PPA). Lacking income, the 740 MW Phase I power station was shut in June 2001, with all employees terminated.

Phase II, which would have trebled the plant's capacity to 2184 MW, was then roughly 5 per cent shy of completion. With the shutdown of Phase I, refusals of state agencies to approve permits to test the Phase II turbines, and the purported repudiation of the PPA, lenders suspended funding for completion of Phase II. Construction stopped, and the contractors left the site.

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In 1992 the government of India announced an invitation to private, including foreign, project developers and lenders to participate in the expansion of the Indian power sector through a "fast track" program. New laws were passed to assure protection of those investments. Enron responded by quickly signing a memorandum of understanding with the government of the state of Maharashtra for a project that would have included not only the largest independent power generation facility in the world but also its own LNG regasification plant, a related gas pipeline, an LNG tanker to access gas supplies in Qatar and a port at the site to accommodate it.

\$1 billion equity?
Execution of the PPA followed in December 1993. MSEB's payment obligations were guaranteed by both the government of Maharashtra (GOM) and, subject to a roughly \$300 million cap, the Central Government.

Based largely on that PPA and those guaranties, Enron raised \$1.9 billion in project debt. It was raised from a coalition of Indian government-owned banks, export credit agencies, a syndicate of offshore, commercial lenders and the Overseas Private Investment Corporation (OPIC), the US government's development-though-foreign-investment-promotion agency. OPIC supplied, at \$160 million, the single largest offshore loan commitment. It also provided \$200 million in political risk insurance for the investments by Enron, GE and Bechtel as well as roughly \$32 million in coverage of one of the commercial banks.

Not everyone was clamoring to get involved, however. The World Bank was approached by India for support. In April 1993, however, the bank's manager for India concluded that the Dabhol plant was "not economically viable."

Within India, the project was the target of political and policy attacks. Critics noted that there had been no competitive bidding. Project costs and power tariffs were higher than other power projects in India, and the concern arose that the cost of Dabhol power could inflate power prices elsewhere. The cost of fulfilling its take-or-pay purchase promise would constitute half of the MSEB's entire budget. Concerns were raised that commitments were made to the project before an environmental impact assessment had been undertaken. Finally, it became known that Enron had allocated a \$20 million "education fund" to prepare the way for the project in India. Critics

assumed that these payments consisted of little more than bribes to procure official support for the project.

*Broken ground
Fin Close*
The controversies blew up shortly after ground was broken, when, in 1995, a change in political control led state of Maharashtra authorities to cancel the project. That dispute was resolved with a renegotiation of the tariff, a reduction of project costs and by the sale by Enron to an MSEB affiliate of a 30 per cent equity interest in the project for \$137 million, reducing Enron's interest in DPC to 50 per cent. MSEB's 30 per cent interest was subsequently diluted to roughly 15 per cent upon its failure to contribute to further equity investments. Nonetheless, there was an expectation creation of a shared interest in the success of the project would, going forward, reduce its vulnerability to political attack.

*137/302
Equity of Plant*
Construction recommenced. There was some cause to hope that the rough times were past. Indeed, Enron's 1998 annual report noted: "The Dabhol power project in the state of Maharashtra is the cornerstone of Enron's activities in India and is expected to be a strong contributor to Enron's earnings in 1999 and beyond."

Time Line
In early 1999, Phase I achieved commercial operation and began supplying power to the Indian grid. It supplied power in a volume, and at a price, that might have been supportable given the demand projections taken seriously by both Enron and Indian officials in 1993. That demand did not, however, develop until after the subsidence of the Asian economic crisis and until roughly, ironically, the time that the project had collapsed.

Asian Crisis & Demand Reduced
The predictions that the project consisted of too much, too soon proved, however, to be prescient. It was clear by 2001 that MSEB neither needed, nor could afford,

the energy it had committed to buy from the project. The October 2000 payment due from MSEB went unpaid until January 2001 when the state Government stepped in to bail out the cash-strapped MSEB. Months of slow payments, and non-payments followed. By June, the project had collapsed.

Though the allocation of responsibility for the allegedly expropriatory actions taken by Indian officialdom remains controversial and to some degree uncertain, it was clear that at the time Phase II was threatening to achieve commercial operation (which would treble MSEB's already taxing offtake obligations). Officialdom came to the rescue with: refusals to permit the testing, and thus the operation, of Phase II turbines; repudiation of Phase I and Phase II payment obligations; and injunctions blocking arbitration of the payment dispute and against taking the steps that would have triggered MSEB's obligation to buy-out the project. With no alternative customers, the project was brought to its knees.

Enron, at 65 per cent the controlling project sponsor, might have been expected to have mounted an aggressive defense of the project. That is what had happened in 1995. Instead, Enron CEO Ken Lay led a delegation to India during the summer of 2001 to seek to close a sale of Enron's equity interest to Indian government interests. The price was rumored at \$600 million to \$1 billion. But India was not buying. By December 2001, Enron was no longer capable of maintaining its core operations, much less prepared to invest in the defense of a large, troubled project.

Thus, by late 2001, the fate of the world's largest independent power project and the largest foreign investment in India was put in the hands of creditors, minority investors, defaulting governmental stakeholders and lawyers.

The Workout

The initial months of attempts to restructure the project were characterized by stalemate. Lenders sought to subordinate the claims of the equity investors. Indeed, the offshore lenders were

London
US
Early holders

somewhat shocked when OPIC acted to block steps being considered to foreclose on the project assets and to expel the equity holders from further involvement. While the documents provided the lenders such rights, the technical expertise of, at least, GE and Bechtel appeared to be critical to restart the Phase I turbines and put the finishing touches on Phase II, much less to undertake the rehabilitation necessitated by the months of abandonment of the project site and facilities.

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A key stakeholder whose interests and position were a source of constant guessing throughout meetings of the project lenders was the Government of India (GOI). The GOI was a party not only because of its defaulted counter-guaranty of the PPA and its inherent interest in seeing the power needs of the country satisfied, but also because of its risk of being held responsible under various international agreements to the extent arguments might be successfully advanced that Indian agencies had engaged in behavior that was, at least in effect, expropriatory. In fact, responsibility for Dabhol was passed rapidly through a series of officials, none of whom seemed charged with the issues long enough to take a position or, in the rare occasion when a position was taken long enough to follow through on it.

When the project was first conceived Enron's role was obviously key. By early 2002, Enron was variously termed "radioactive," "contaminated," and "obstructionist". Perhaps the only issue on which the offshore lenders, the Indian

banks, GE and Bechtel, and the GOI could agree was that the continued presence of Enron made a difficult situation worse. It would be better for everyone if Enron were to go quietly, but at what price? No one was willing, or expected anyone else to be willing, to advance the sorts of funding that Lay had sought during his summer 2001 sales tour in India.

In an internal meeting at OPIC during the summer of 2002 the suggestion was raised that, notwithstanding the offer price of the previous summer, the continued deterioration of both the project and of the apparent prospects for early resolution of the various claims and disputes might well have led Enron's creditors' committee to ascribe a minimal value to Enron's investment. Perhaps Enron might be bought out for what previously would have been considered a small number. The further idea arose to propose that OPIC might return to Enron the roughly \$16 million that had been paid over the years by Enron to OPIC for political risk insurance coverage of a portion of Enron investment. Rather than simply rescinding the contract and thereby resolving the pending claim, the proposal would be that Enron would turn over to OPIC, or its designee, its full interest in the project.

Enron countered with the request that it also receive interest on the returned premium and also be compensated for certain outstanding claims which it held against the project company. It was fairly quickly agreed, however, that, in exchange for the rough equivalent of a return by OPIC of the insurance premiums paid by Enron, Enron would walk away not only from its pending \$142 million claim against OPIC but also from its full interest in the project, assigning the Enron-owned shares to OPIC or its designee.

A key issue was who would be that designee? DPC was an unlimited liability company embroiled in litigation and potential claims, so taking over a controlling interest in such an operation would carry risks. Two parties that were not interested in increasing their exposure were GE and Bechtel. So, for some weeks the search was on for someone who would

Enron
claim
to
OPIC

accept the shares and control of DPC. In due course, however, GE and Bechtel decided that the liabilities could be managed and that control of DPC was the best way to assure that the claims and potential claims that DPC held against Indian authorities would be retained. So, the Enron-buyout was structured so that Enron's control of DPC passed to GE and Bechtel in exchange, in effect, for a return to Enron of insurance premiums previously paid to OPIC.

Though there was unanimous support for Enron's departure, an ironic impediment arose to closing the transaction – the GOI. One term of the GOI's counter-guaranty of the PPA was that Enron's ownership should not be less than 26 per cent. While discussions with the finance ministry had led to concurrence that Enron should go, and that the GOI would waive the requirement of at least 26 per cent Enron participation, as the transaction was being structured and approaching implementation, the GOI failed to provide consent. The GOI position was simply that they no longer cared whether Enron was in or out.

OPIC was not, however, willing to support a transaction that could have cost offshore lenders a \$300 million asset. This evolved the transaction that came to be known as "Enron Lite." The decision was to structure the Enron buy-out in two phases. The first would reduce Enron's interest to just over the required 26 per cent – enough to give GE and Bechtel control of DPC and to assure their ability to continue enforcement of DPC's claims against MSEB, the GOI, the GOM and other defendants. Enron would be fully compensated upon closure of the first phase, but would transfer the balance of its interest only when directed, which would occur after GOI had consented or the other parties had decided to go forward notwithstanding the absence of GOI consent.

Enron Lite was approved by the New York Bankruptcy Court on April 8, 2004, and closed by the end of that month.

Not much else that ultimately proved dispositive seemed to occur in workout

efforts underway since 2001. There were a series of proposals regarding the buy-out of the project company and/or its assets. But lack of cooperation by one or another of the necessary participants stood in the way of progress. Efforts to clarify the completion and offtake support that a restarted and complete project would enjoy from Indian officialdom reached a dead end at the doors of the relevant ministries. Deposits proffered by prospective buyers were returned.

Indeed, a primary consequence of months of intermittent meetings and rebuffed proposals appeared to be deteriorating relationships and an ever-increasingly likelihood that the workout would ultimately consist of little more than pressing and settling lawsuits. That risk was enhanced when, in 2002, the Indian banks, in violation of their intercreditor agreement with the offshore lenders, appealed to the Bombay High Court for appointment of a receiver to assume control of DPC's assets. What from

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one perspective was merely the predictable action of lenders taking reasonable steps to preserve their collateral appeared from another to confirm that GOI-controlled interests were committed to expropriate this previously foreign-owned asset. It led to yet further litigation, as the offshore lenders collectively filed for arbitration against the Indian banks, claiming violation of their intercreditor agreement.

Workout discussions evolved from debates over the best way to sell the plant to third parties and allocate the proceeds – and losses – from that sale, into a focus on the offshore interests being bought out by the Indian banks already exposed to the project.

Most developments were litigious. In September 2003, an arbitral panel found against OPIC's position that certain protective provisions of the GE and Bechtel political risk insurance policies should be applied and ordered OPIC to pay their respective expropriation claims. In January 2004, at OPIC's instigation in order to recover these payments as well as payments made to an insured bank and, as described above, to Enron, the United States Government called for an arbitration against the GOI alleging expropriation of the Dabhol Power Project. This was the first time in OPIC's history that an arbitration was initiated against a host government under the bilateral agreements pursuant to which OPIC conducts its political risk insurance program. GE and Bechtel each initiated arbitrations under the India-Mauritius bilateral investment treaty, taking advantage of the structuring of their respective investments in DPC through Mauritian subsidiaries. Several offshore commercial lenders were exploring their options at following suit by filing bilateral investment treaty arbitrations.

Things were looking quite bleak when, in March 2005, the situation changed dramatically. In meetings in Washington among the Indian banks, the offshore commercial lenders and OPIC, the Indian banks tabled terms that were significantly better and, as it turned out, well within the range of what most commercial lenders had already decided would be acceptable. Within 48 hours, a deal had been initialed that included settlement of OPIC's pending claims against the GOI for reimbursement of what it had paid in claims to insured investors.

Separately, if not independently, talks were underway between the same Indian banks and GE and Bechtel seeking both an assignment of their equity interests in the project and their commitment to cooperate with the restart and completion of the project. There too, the prospect for progress appeared better.

While the precise terms evolved, and additional time was required to come to terms with the equity investors, by late

~~Handwritten scribble~~

Nikolaus

Gutshofelder
König

June, the settlements were falling into place. On July 8, the GE settlement closed. On July 12, the offshore lender position was acquired by a special purpose vehicle acting for the Indian banks. On July 16, OPIC and Bechtel settled, leaving the project, for the first time, fully owned and controlled by Government of India interests. Part of the settlement is the expectation that Phase I will, within the coming year, be restarted and Phase II will be completed.

OPIC's Role Helped.

OPIC played a pre-eminent role in both the creation of the Dabhol power project and the workout. On the creation side, OPIC's participation was crucial, as it agreed to provide \$160 million in investment guaranties, in addition to providing roughly \$225 million in political risk insurance on both the debt and equity sides. Wearing its governmental hat in the deal, OPIC brought the full faith and credit of the USG to the table, if ever needed. This nascent role proved pivotal at various stages of the workout.

From the time of the shutdown of the plant in 2001, OPIC's vision was unwavering: to conclude a comprehensive commercial settlement, with fair treatment of all stakeholders' claims. OPIC's strong opposition surprised the other lenders but kept alive the prospect of salvaging the project.

In pursuit of OPIC's vision, and to simplify the complex array of stakeholders, OPIC devised and executed a plan to buy out Enron's interest in the project, increase the equity shares of GE and Bechtel, and settle Enron's \$142 million claim against OPIC under its insurance policy. By negotiating an acceptable price for Enron to relinquish its interests in Dabhol, and funding the cost of the transaction whereby Enron's equity shifted to GE and Bechtel, OPIC removed an onerous presence from the workout and settled a large claim on extremely favorable terms. It also advanced OPIC's goal of a fair settlement.

OPIC's position eventually prevailed, for many reasons. The change in the GOI's political leadership, the authority and resolve demonstrated by the new Indian negotiators,

the looming \$6 billion Bechtel and GE arbitrations, the USG arbitration, the offshore banks' threatened arbitrations under bilateral investment treaties, the shortage of power in Maharashtra, and even general frustration and the size of mounting expenses may all have contributed to the sudden change in the Indians' negotiating position in March 2005, and all therefore contributed to the comprehensive commercial settlement that was achieved.

Dabhol – Past or Prologue?

Investment failures of the magnitude of Dabhol are not common. Boasting a complexity and longevity that prompted four case studies by Harvard business school, the project and subsequent workout brought together a cast of international actors, enormous financial resources, and powerful global political entities that defy quick replication. As future sponsors, bankers, government entities and policy analysts assess Dabhol and its meaning for potential projects, they will conclude that Dabhol's executed agreements contained attractive financial, legal, and political

ultimately, unreliable. To the extent that the failure can be blamed on governmental deference to unrealistic claims proffered by an energy superpower, the likelihood of the mistake repeating itself, at least on a similar scale, would seem to be slight, if only for the absence of any industry player that carries such weight.

Neither investors nor their official hosts want a repeat of Dabhol. The government surely concluded, as would other government-investors who view the Dabhol model, that the project's failure carried a high price, measured in some 30 arbitrations and lawsuits, the first government-to-government arbitration with the United States under an investment incentive agreement, an international black eye for alleged serious expropriatory acts, and reduced foreign investment as a consequence of the impaired investment climate. Investors' preferences are bound to tend toward environments where host government undertakings, if made, can be taken seriously.

It is difficult to measure the cost to India of Dabhol, particularly with the overlay of the economic boom that is now being enjoyed. There can be little doubt, however, that, all else equal, the experience of Dabhol makes investors wiser and slower, in committing their resources to India. The attraction is still there, but the calculation today has to compensate for risks that, before Dabhol, would not have been given as much weight.

Dispute that share many characteristics of Dabhol, though smaller, are likely. The root causes of Dabhol's downfall are not grounded in any particular corporate culture, the politics of one nation or the economics of one business sector. Rather, a Dabhol-like controversy could arise in any privatization anywhere, and even if the investor were a model corporation. Such a dispute might be especially likely to arise in connection with a new private "greenfield" project in a sector that was previously the exclusive domain of state-owned enterprises.

Fifteen years ago, infrastructure firms saw enormous business opportunities in

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protections for all the stakeholders, yet the project failed. This fact must give all pause.

As a potential stakeholder in potential power projects, Enron must be regarded as unique and its bankruptcy thereby diminishes the likelihood of another Dabhol. Wielding a weight which its subsequent collapse revealed as deception, Enron achieved, through sheer tenacity and negotiating skill, a set of Indian government-backed guaranties that were as remarkable as they were,

developing countries and the newly emerging market economies of Central and Eastern Europe and the former Soviet republics. Their expectation was that the combination of pent-up demand, projected economic growth, the need to modernize and upgrade existing infrastructure, and the realization that bilateral and multilateral assistance would not be provided on anything like the scale required to accomplish all of this, would create unprecedented new private investment opportunities.

Whether enthusiastic about rejoining the Western world or resigned to the passing of a statist world order of one sort or another, host governments entered into investment agreements for privatizations or new projects to modernize and expand their infrastructure: power, water, telecommunications, highways, sea ports, airports, etc. Some policymakers in the West took pride in the newly dominant role that private capital was playing in the economic development process, viewing this as yet another triumph over Marxism.

It did not take long for the contradictions between the assumptions of foreign private investors and the mentality of public officials and the general population of host countries to assert themselves.

Suddenly, running water is available that is safe to drink, it is possible to have a telephone installed within days instead of years, calls and faxes reliably go through, electric power functions 24/7, and better transportation infrastructure supports the growth of tourism, manufacturing, etc. But, utility rates rise, there are tolls to pay, privatized utility companies trim payrolls and expect the remaining workers to show up for work, and the profits from these impositions go to foreigners. What more does an opposition party need for a domestic campaign issue, to be followed by an international investment dispute, no matter which party wins the election? Indian politicians were criticized for making Dabhol a political issue at the state and national level, but few politicians anywhere could have resisted such a temptation.

Recent potential expropriation cases are unlike the Latin American claims of the

1970's, where host governments overtly asserted control over natural resources, or the fairly obvious claims that arose in Vietnam and Iran. Recent expropriation claims arise from various sorts of public/private partnerships that have gone wrong, privatizations that have been reconsidered, economic crises that have been mishandled, and even economic reform efforts that have unintended consequences. They are difficult to resolve as "all or nothing" liability claims, but the

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very presence of valid competing interests that makes a finding of liability difficult should offer grounds for settlement.

What To Do When the Situation Sours?

When OPIC receives notice of a potential expropriation claim, or just an investment dispute involving an insured investor, OPIC consults with the insured investor and may intervene with the foreign government in an attempt to resolve the dispute or avert the claims. These so-called "advocacy" efforts are nothing new, but OPIC has recently attempted to formalize them by creating an Advocacy Center through which such requests for intervention can be managed. Counterpart agencies of other governments may provide similar assistance, and the World Bank's Multilateral Investment Guarantee Agency ("MIGA") has achieved some success in resolving disputes between investors from member countries and governments of other member countries.

Government and multilateral insurers have well-established, open avenues of communication with host

country officials and, as investment promotion agencies, can create incentives for resolving disputes. Host country governments perceive such agencies as development institutions implementing mutually advantageous investment encouragement programs, notwithstanding their own financial interest in achieving a resolution that avoids a claim against them, and so they can play the role of honest broker while protecting their own economic interests.

As in any other advocacy situation, it helps to have the facts and the law on your side, and the investor is in a position to help in both respects. Project agreements that create rights and enforceable remedies are a good starting point. The ability to invoke foreign investment laws and investment protection treaties enhances the investor's position. Awareness of "pressure points" such as the visit of a head of state, the periodic meeting of a joint economic commission, and the opportunity to challenge a country's eligibility for trade or investment benefits or economic assistance contributes to a successful advocacy campaign.

Sources of Information

Governments may prefer diplomacy and confidentiality, but pressure on governments and international organizations for greater "transparency" makes a great deal of information about investment disputes publicly available, and the Internet makes at least recent information transparent. An investor who has become involved in an investment dispute with a country may wonder whether others are having, or have had, similar problems. Better yet, an investor contemplating an investment in a country may wonder whether that would be a wise move given the experience of predecessor investors.

If a country has signed investment protection treaties or the ICSID Convention, investment disputes may have been submitted to ICSID arbitration. A visit to ICSID's website will reveal whether there

are any pending or decided cases involving that country. If the case is still pending, one can learn the investor involved and the procedural history of the case. If the case is decided, the decision will be available, if not through the website, then from the ICSID Journal. As of September 10, 2005,

the website lists 97 pending cases. Argentine claims predominate, with an otherwise wide geographical distribution.

OPIC has always published its claims determinations and cumulative claims history. Recent claim determinations (since 1996) are available

at OPIC's "electronic reading room" (www.opic.gov/FOIA/Electronic FOIA Reading Room). The annual reports of OPIC, MIGA and other investment insurers often contain information about recent claims and investment disputes. At a level of generality, one can obtain information about the investment climate of any country, including investment disputes, from State Department background notes on that country (www.state.gov).

Armed with this information, an investor may be able to form alliances, share information, demonstrate that its difficulties are not unique, and contribute to the public pressure on the foreign government to face up to the problem and resolve it fairly.

There are multiple stakeholders in any project, and all can be enlisted in resolving an investment dispute. The project sponsors and investors are the most obvious, but suppliers and customers are also stakeholders, along with their governments and specific agencies of those governments with divergent and even conflicting interests.

Finally, unless there is something fundamentally wrong with the project or the host government has totally reversed its position on foreign investment, it too will wish to put the problem behind it and move on. So, the host government may be part of the problem, but, pursuing its own interests for its own reasons, the host government often proves to be, as in the settlement of the Dabhol claims, a key element in the solution. ■

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Enron vs. Others Failures

Why Was the Workout So Difficult?

1. **Poor economic assumptions.** It is an unenviable fact that all the stakeholders in Dabhol, whether debt, equity, or government guarantor, miscalculated, perhaps badly, concerning the assumptions and financial model they believed would produce enough revenue under the power purchase agreement to run the plant, service and repay the debt, provide a sufficient return on equity, and provide for future capitalization. The financial agreements called for the \$2.9 billion project to be funded by \$1 billion in equity from Enron (80 per cent), Bechtel (10 per cent), and GE (10 per cent); \$1.2 billion of project debt was to come from the Indian Banks, \$160 million from OPIC, and the remainder from a syndicate of offshore lenders and export credit agencies. Had any stakeholder opted out, as the World Bank did based on their study that concluded the project was likely to fail, that stakeholder would have saved time, money, and economic opportunity lost by those stakeholders who stayed in the project.
2. **Failure of the GOI.** When Enron, Bechtel, and GE secured the impressive guaranties and economic concessions from the GOI, it's hard to imagine that they foresaw the upcoming failure of the GOI to honor its financial and contractual obligations, much less the GOI's course of conduct that was deemed expropriatory by an American arbitration panel. In addition to failing to honor its counter-guaranty, the GOI also, through its judiciary, improperly thwarted international arbitration panels from proceeding. Most importantly, however, the GOI refused to commit the resources to solve the problems raised through the project's failure. For four years, the GOI presence consisted of representatives without sufficient negotiating authority who frequently were replaced by new representatives, who similarly lacked negotiating authority.
3. **Failure of the GOM.** The government of Maharashtra was the sole purchaser of power under the PPA, and was also, ultimately, a 15 per cent equity holder in the project. Through its subsidiary, MSEB, the GOM was a prime mover in every aspect of the deal's completion, and was the chief beneficiary of the PPA due to the state's energy starvation. When it refused to honor its financial obligations, including a direct, unlimited financial guaranty, the GOM threw a massive obstacle in the path to a fair workout. This unforeseen contractual breach was followed by the GOM's participation in important arbitrations and lawsuits, sometimes willingly, sometimes not. The GOM also utterly failed to participate or assist the long workout efforts. Their absence was as confounding as it was difficult to work around.
4. **The positions of GE and Bechtel.** The differing negotiating positions of the sponsors during the workout cut both ways on this issue. They took an aggressive stance in litigation and arbitration, pursuing claims against the GOI, GOM, MSEB, and MPDCL through a variety of causes of action and venues.